

IN THE HIGH COURT OF GUJARAT AT AHMEDABAD

INCOME TAX REFERENCE No 151 of 1984

For Approval and Signature:

Hon'ble MR.JUSTICE J.N.BHATT and
MR.JUSTICE A.R.DAVE

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1. Whether Reporters of Local Papers may be allowed to see the judgements?
 2. To be referred to the Reporter or not?
 3. Whether Their Lordships wish to see the fair copy of the judgement?
 4. Whether this case involves a substantial question of law as to the interpretation of the Constitution of India, 1950 of any Order made thereunder?
 5. Whether it is to be circulated to the Civil Judge?

RANOLI INVESTMENT (P) LTD.

Versus

COMMISSIONER OF INCOME TAX

Appearance:

MR. D.A.MEHTA, MR R.K.PATEL & MR B.D.KARIA FOR
MR KC PATEL for Petitioner
MR MANISH R BHATT for Respondent

CORAM : MR.JUSTICE J.N.BHATT and
MR.JUSTICE A.R.DAVE

Date of decision: 02/02/99

ORAL JUDGEMENT(Per J.N.Bhatt, J.)

A short, but, interesting question which has come up before us for opinion in this reference under section 256 of the Income Tax Act, 1961 (IT Act) is as to whether the exercise of power in imposing additional income tax of

Rs.52,009/- by the Income Tax Officer under section 104(1) of the IT Act and confirmed by the Appellate Authority and further confirmed by the Income Tax Appellate Tribunal is justified or not, by referring a specific question as follows:

"Whether on the facts and in the circumstances of the case, the Tribunal was justified in law in holding that the Income-tax Officer was justified in passing order u/s.104(1) of the Income-tax Act, 1961 and in levying additional tax of Rs.52,009/-?"

We have heard the learned counsels appearing for the parties and we have examined threadbare the relevant proposition of the provisions of section 104(1) of the IT Act and before we render our opinion in this reference, let us have a skeleton spectrum of relevant facts leading to the rise of this reference under section 256 of the IT Act, which is, at the instance of the Assessee Company.

The assessee Company is an investment company in which members of the public are not substantially interested. Its accounting period is year ended 30.9.1976. According to the return filed by the assessee Company, the profits as per the books of accounts were Rs.37,761/-, whereas, the dividends proposed were Rs.28,800/-. The declaration of the dividend came to be made on 3.10.77, i.e. it was three days beyond the statutory period of 12 months.

The concerned ITO, found at the time of assessment of the return relating to the assessment year 1977-78 of the previous accounting period ending 30.9.76 that one company, namely, M/s.Ahmedabad Manufacturing & Calico Printing Company Ltd. ('Calico Mills' for short, hereinafter) in which the assessee Company is a shareholder had declared dividend on 10.9.76 which means prior to the expiry of the accounting period in question. It will also be interesting to note that the amount of dividend coming to the share of the assessee Company was Rs.59,375/-. However, the dividend was received after the end of the accounting year ended 30.9.76. It was, therefore, claimed by the assessee Company that it was not required to be taken into consideration for the purpose of dividends since the same had not been received before 30.9.76.

The ITO considering the relevant provisions of section 104(1) of the IT Act, as it then stood, determined the distributable income in accordance with law and held that the assessee company had no reason to declare so low a

dividend as was actually done as the company was fully aware of the principles of accrual of dividend and the availability of funds at the time of General Body Meeting. ITO also reached to the factual conclusion that no dividends were declared within 12 months and also that no reason for delay had been tendered.

The ITO, therefore, while making the assessment for the assessment year 1977-78 under section 143(3) of the Act on 15.2.79 on a total income of Rs.27,620/- found that there was a fit case for exercising the power under section 104 of the IT Act against the assessee company for the assessment year 1977-78, as a result of which, notice came to be issued under section 105, which was responded by the company. The assessee company, inter alia, contended that the company had distributed dividend to the extent of profit available as per the profit and loss account of the company for previous year relevant to the assessment year 1977-78. The difference between income returned and the income assessed is mainly on account of the inclusion of dividend from Calico Mills amounting to Rs.59,575/- received, accounted and offered for tax by the company in previous year relevant to assessment year 1978-79. In the profit and loss account, the company had also debited the amount of Ra.1446/- being the company's share in the loss of partnership firm M/s.Design. It was, of course, not allowed while computing the total income for assessment year 1977-78 as the loss pertained to assessment year 1976-77. If the distributable income is computed after excluding the dividend from Calico Mills and after allowing the loss from M/s.Design, then the assessee company had distributed dividend in excess of statutory percentage on distributable income, as contended before the ITO.

The ITO by his order dated 30.3.81 held that there was a fit case for exercise of power under section 104(1) of the IT Act and levied additional tax of Rs.52,009/-, which was questioned before the Commissioner of Income Tax (Appeals), but without success. The appeal of the assessee company came to be rejected on 28.7.82. The Income Tax Appellate Tribunal also decided against the assessee and in favour of the Department. That is how, at the instance of the assessee company, the aforesaid question of law has come up before us in this reference under section 256 of the IT Act.

The contentions are reiterated before us on behalf of the assessee Company which were rejected by the authorities below. It cannot be said that the interpretation propounded by the Tribunal while confirming the order of

the ITO with regard to provisions of section 104(1) of the Act, as it then stood, is in any way unjust, unreasonable, inequitable, perverse or based on misreading of the facts or provisions of law, requiring interference of this Court in the reference under consideration. When we find and agree with the authorities below we need not divulge on the same grounds reiterated before us and dwell upon individually. Notwithstanding that, we would like to highlight certain important and relevant aspects as the question of law referred to us is also a significant one.

After having taken into account the factual scenario emerging from the record of the present case, in the background of the relevant provisions of law propounded in section 104(1) of the IT Act, we are of the clear opinion that the impugned order of the Tribunal is justified requiring no interference in this reference. It is amply clear from the provisions of sub-section 1 of section 104 of the IT Act which clearly lays down that the ITO concerned shall pass order charging an additional income tax from a closely held company if he is satisfied that in respect of any previous year the profits and gains distributed as dividends by the company within 12 months immediately following the expiry of that previous year are less than the statutory percentage of the distributable income of the company of that previous year. It may be recalled that it is not in question before us that the above conditions are established in the present case. In other words, it means:

(i) that the assessee company has not distributed within 12 months immediately following the expiry of the previous year ending on 30th September, 1976, 90 per cent of the distributable income which had been worked out by the ITO at Rs.33,218/-. We need not repeat that the correctness of the aforesaid working of figure by the ITO concerned has not been questioned by the assessee company before us. Again, nothing has been successfully pointed out on behalf of the assessee company which would prompt us to take a detour or a departure from the route charted by the appellate Tribunal.

(ii) The contention of the assessee company that the dividend income derived by it from Calico Mills did not form part of the commercial income of the assessee for the purpose of the previous year corresponding to the assessment year 1977-78 is also not accepted. We also find that such a

contention is not acceptable at all. Calico Mills not only declared the dividends within the previous year ending on 30th September, 1976, but it also prepared the dividend vouchers for the dividend payable to the assessee company on 27.9.76.

It has been propounded by host of judicial pronouncements that the word 'profits' as used in sub-section 1 of section 104 of the IT Act has to be understood in the sense of commercial profits. The dividend, therefore, has to be distributed out of the commercial profits, and therefore, the ITO was obliged to first consider the commercial profits and not the distributable income as defined in clause (1) of section 109 of the IT Act, with reference to which additional tax is chargeable as per the provisions of sub-section (1) of section 104. In the present case, the commercial profits of the assessee company as per its own books of accounts had been worked out to Rs.31,761/-. Again, the company being an investment company should have distributed 90 per cent of the above income i.e. Rs.28,585/- by way of dividends. There is no dispute about the fact that such dividends has not been distributed within the period of 12 months from the end of the accounting period, namely, within 12 months from 30th September, 1976. The company distributed dividends amounting to Rs.28,800/- on 3.10.79, i.e. after the statutory period was over on 30.9.77. The assessee company has not been able to raise a defence that it could not declare the dividend within the statutory period on account of the smallness of the profits or losses incurred by the assessee company in earlier years or other similar causes. Therefore, it clearly emerges from the record of the present case that the assessee company was in a position to distribute the dividends and it did distribute the dividends, but such distribution was not made within the statutory period in view of the amendment which came to be introduced by the Finance Act, 1973. Under section 104(1) of the IT Act, additional tax shall be leviable on the distributable income as reduced by the amount of dividends actually distributed, if any. It is a very clear proposition of law that "within the said period of 12 months" thus making it clear that the distribution beyond the aforesaid 12 months period shall not be taken into account. This contention was rightly dealt with by the authorities below.

The assessee company cannot be allowed to contend that the Department will not be a loser in the present case in view of the factual scenario because only one company

owned shares of the assessee company and its accounting period ended on 31.3.78 and the dividend declared on 3.10.77 would be as much be a part of its total income for the assessment year 1978-79 as the dividend declared on or before 30th September, 1977 would have been apparently losses.

The Legislature in its wisdom has, rightly, provided sub-section (1) in section 104 in Finance Act, 1973 and there is a purpose and policy behind it. The underlying design and decideratum is evident and apparent. In many tax systems of advance States in the world, there is regulation of accumulation of undistributed corporate profits, considered either unhealthy from certain economic points of view or as opening up avenues for evasion of higher personal tax liability. The policy of the section is to deter the corporate bodies of the type which fall within its ambit, from accumulating the undistributed profits beyond a certain limit. There is no dispute about the fact that the rates of taxes are different in case of individual and in case of corporate sector. The provision is, therefore, devised and evolved to see that in an appropriate case, additional income tax is levied on undistributed profits. No doubt, the conditions for attracting the rigours of the provisions of section 104(1) of the IT Act had to be established before exercising powers thereunder. The condition is that the Income Tax Officer must be satisfied that (i) in respect of any previous year (ii) the profits and gains distributed as dividends by a company (iii) within the 12 months immediately following the expiry of the relevant previous year (iv) were less than the statutory percentage of its distributable income for the previous year.

If an Income Tax Officer, while making an assessment, is satisfied about the aforesaid tests and requirements, it is incumbent upon him to exercise the powers for levying additional income tax on undistributed profits under the provisions of section 104(1) of the IT Act. Therefore, when, once the ITO is satisfied that in respect of any previous year the profits and gains distributed as dividends by any closely held company within the 12 months immediately following the expiry of that previous year were less than the statutory percentage of the distributable income of that previous year and that it would not be unreasonable to distribute a larger dividend than that declared, he has no option but to pass an order in terms of section 104(1) of the IT Act. The expressions 'profits and gains' and 'undistributable profits' have been extensively explored and very well

expounded by catena of judicial pronouncements and, therefore, that would not detain us any longer.

Having regard to the overall picture emerging from the record of the present case and after having heard the rival submissions raised before us, our clear opinion is that the present reference is required to be answered in affirmative, i.e. against the assessee and in favour of the Department and we answer accordingly. The reference shall stand disposed of accordingly.

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